Supreme Court, U. S.
FILED
DEC 27 1973
MICHAEL RODAK, JR., CLERK

No. 73-750

IN THE

Supreme Court of the United States

OCTOBER TERM, 1973

JOAQUIN G. BLAZ, DIRECTOR OF REVENUE AND TAXATION, GOVERNMENT OF GUAM, *Petitioner*

v.

JOHN L. MANNING AND CARLYN T. MANNING, HUSBAND AND WIFE, AND GENERAL INSURERS, INC., *Respondents*

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

REPLY MEMORANDUM FOR THE PETITIONER

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REPLY MEMORANDUM FOR THE PETITIONER

In its brief in opposition, respondents argue that the petitioner's statement of the "Question Presented" is erroneous. It is the position of the petitioner, as stated in the petition for a writ of certiorari, p. 2, that, if the decision below were left to stand intact, it would necessarily follow that *all United States citizens, whether or not they have Guam-based income, would be fully taxable for years prior to 1973 in both the United States and Guam on their entire worldwide income. Sayre & Co.* v. *Riddell,* 395 F.2d 407, 412 (9th

Cir. 1968). Respondents state that "the [preceding] proposition is simply a statement of intention by respondent [sic] to try to tax United States citizens in that manner if he is not successful in this litigation." Respondent's brief in opposition, p. 2.

The petitioner respectfully submits to this Court that, based on the court of appeals decision below (which concluded that non-Guamanian United States citizens are not to be treated as nonresident aliens of Guam for purposes of Sections 142(b)(1), 1371(a)(3) and 6013(a)(1) of the Internal Revenue Code of 1954 (the "Code")), non-Guamanian United States citizens who do not reside in Guam are to be taxed on their worldwide income in both Guam and the United States for years prior to 1973, because only nonresident aliens can have their reportable gross income limited to the income from the jurisdiction involved. Section 871 of the Code; Section 1.871-1 of the Treasury Regulations on Income Tax (1954 Code). See also petition for certiorari, pp. 14, 15. The Ninth Circuit itself recognized this principle in *Sayre* when it stated that Section 881 of the Code does not apply "to corporations domestic to Guam, which must pay the Guam territorial income tax upon all of their net income, wherever earned." *Sayre & Co.* v. *Riddell, supra,* 412. The same principle applies to individuals under Sections 1 and 871 of the Code.

In support of their position, however, respondents maintain that even native born Guamanians who do not reside in Guam have never been taxed on their worldwide income by Guam. This statement is incorrect. The reason why most native born Guamanians who reside in the United States were not required by the Guam tax officials to file a return in Guam is that

prior to 1973 Guam permitted such individuals the benefits of Section 911 of the Code (and its $20,000 or $25,000 exclusion). Where, however, such an individual had Guam source income or had earned income in the United States greater than the maximum amount excludable from his gross income under Section 911, the Guam tax officials have always maintained that such an individual must file a Guam tax return. Such an individual would then be permitted the benefits of Sections 901 and 911 on his Guam tax return and Section 901 on his United States tax return so as to reduce, if not completely eliminate, any double taxation that may arise by having to file two different returns that include his worldwide income. Moreover, Guamanians who do not reside in either Guam or the United States have always filed their returns that include their worldwide income with Guam and not the United States.

The instances where a Guamanian had to file two tax returns which included his worldwide income under the preceding circumstances have been few. The petitioner has always recognized the inequities involved in such a method of taxation; this was one of the reasons the petitioner fully supported the legislation which became the Act of October 31, 1972, P.L. 92-606, 86 Stat. 1494.

The petitioner does not presently desire to tax non-Guamanian United States citizens who do not reside in Guam on their worldwide income for years prior to 1973. However, the petitioner believes that he would be justified in so doing under the opinion below and, therefore, *respectfully urges this Court to grant the petition for a writ of certiorari so that this question can be resolved at the present time.*

In their brief in opposition, respondents argue that (1) economics and administrative difficulty are improper arguments; (2) Guam loses no revenue to which it is entitled under the decision below; (3) Section 932 of the Code is inapplicable to Guam; and (4) the Act of October 31, 1972, *supra,* is in accord with petitioner's pre-1968 conduct and with the court of appeals decision.

1. Economics and Administrative Difficulty Are Proper Arguments.

One of the considerations governing review on certiorari in tax cases is whether the appellate court's decision "would afford a precedent for the tax treatment of substantial sums" of money. *United States* v. *Chicago, Burlington & Quincy Railroad Co.,* 412 U.S. 401, 404 (1973). See also *Commissioner* v. *Lincoln Savings & Loan Association,* 403 U.S. 345 (1971). Where, as in the situation presented in these consolidated cases, the appellate court's decision will result in potential claims for refund in the amount of at least $1,961,723, plus statutory interest, this evidentiary matter is important and is one of the principal reasons for requesting that this Court grant certiorari.

In determining the potential revenue loss to the Government of Guam under the decision below (which amounts to 5 percent of the income tax assessments in Guam for 1972), the Deputy Commissioner of Revenue & Taxation limited his survey to those returns filed in Guam in 1970, 1971 and 1972 by non-Guamanian United States citizens because the statute of limitations for filing claims for refund for these years has not expired. Section 6511(a) of the Code. For the calendar year 1970, the statute of limitations will expire on April 15, 1974. Although the dollar amount of potential

revenue loss may not seem substantial when compared to the tax revenues collected in the United States, for a territory such as Guam, a 5 percent revenue loss will create severe economic consequences in the operation of the Government.

The decision of the court of appeals will require the Office of the Director to review every claim for refund filed in Guam by non-Guamanian United States citizens. In addition, to the extent that any tax paid to Guam is refunded to such an individual, the individual must report and return to the United States taxing authorities the corresponding decrease in the foreign tax credit previously claimed on his United States income tax return. See Section 905(c) of the Code. Thus, the decision below may affect, and result in, the review and audit of over 9,000 tax returns filed in Guam and the United States. Accordingly, the decision below also places an administrative burden on the Commissioner of Internal Revenue.

2. Guam Loses Revenue To Which It Is Entitled.

The respondent urges that Guam loses no revenue to which it is entitled under the court of appeals decision. Since the enactment of the Organic Act of Guam, Guam tax officials, United States tax officials and Congress have stated and believed that non-Guamanian United States citizens who did not reside in Guam were treated as nonresident aliens in Guam for Guam income tax purposes prior to 1973. See Rev. Rul. 8, 1953-1 Cum. Bull. 300; H. Rep. No. 92-1479, 92nd Cong., 2. Sess., 9 (1972) (3 U.S.C. Cong. & Adm. News (1972) 5408). The relevant revenues and expenditures that are taken into account in planning the operation of the Government of Guam were determined under this principle of law until 1973.

Under the court of appeals decision, instead of this revenue being entirely payable to the Government of Guam, as expected, the ultimate beneficiary of most of this revenue will turn out to be the United States. This follows by reason of the operation of the foreign tax credit under Sections 901, 904 and 905(c) of the Code. In other words, where (as a result of the decision of the court of appeals) a non-Guamanian United States citizen receives a refund of Guam income tax and is taxed in the United States at an average tax rate that is less than the 30 percent rate attributable to nonresident aliens under Section 871(a), he is required to report and return a portion of his refund to the United States because of a proportionate decrease in the available foreign tax credit originally claimed on his United States return. If, however, such an individual is taxed in the United States at an average tax rate that is 30 percent or greater, then he gets a full credit on his United States tax return for taxes paid to Guam. Thus, any refund to such an individual of taxes paid to Guam will cause an equal or proportionate increase in taxes payable to the United States. In essence then, if the decision below is allowed to stand, to the extent that non-Guamanian United States citizens reduce their taxes paid to Guam for the taxable years 1970, 1971 and 1972 and thereby increase their taxes paid to the United States, *Guam will be subsidizing the United States with revenues that Congress intended the Government of Guam to have.* See H. Rep. No. 92-1479, *supra,* wherein Congress specifically stated that prior to 1973 non-Guamanian United States citizens who did not reside in Guam were treated as nonresident aliens of Guam for Guam income tax purposes.

3. Section 932 Was Applicable to Guam Prior to 1973.

(a) It is petitioner's position that, with respect to taxable years beginning before January 1, 1973, Section 932(a) of the Code specifically treated Guamanians, who were collectively United States citizens by reason of the Guam Organic Act, the same as nonresident aliens of the United States for Federal income tax purposes. It is clear that this is a correct interpretation of the law. See Rev. Rul. 56, 1953-1 Cum. Bull. 303; Rev. Rul. 70-230, 1970-1 Cum. Bull. 166. Nothing in *Flores* v. *Government of Guam,* 444 F.2d 284 (9th Cir. 1971), or the decision below, leads to a different conclusion. See O.D. 333, 1 Cum. Bull. 267 (1919), which applied the principle of Section 260 of the Revenue Act of 1918 (predecessor to Section 932) to the Virgin Islands by stating:

> Citizens of the Virgin Islands who are not otherwise citizens of the United States and who are not residents of the United States are taxed only on income from sources within the United States [*i.e.,* as nonresident aliens]. Citizens of the Virgin Islands who are residents of the United States are taxed on the same basis as other citizens of the United States.

The petitioner knows of no authority, and the respondents cite no authority in their brief, to support the proposition that Section 932 and its predecessor provisions were enacted for the express purpose of classifying United States nationals of territories and possessions as aliens for income tax purposes only. This is simply incorrect. This is demonstrated by the continued application of Section 932 to citizens of the Virgin Islands who are collectively citizens of the United States under Section 306 of the Immigration

and Nationality Act (8 U.S.C. 1970 ed. § 1406), but are not otherwise citizens of the United States and who are not residents of the United States. Such individuals are still treated as nonresident aliens of the United States for Federal income tax purposes. See Section 1.932-1(a) of the Treasury Regulations on Income Tax (1954 Code).

Accordingly, in order for non-Guamanian United States citizens who did not reside in Guam to have had the equality of treatment under the mirror system of taxation, it must follow that they are to be treated as nonresident aliens of Guam for Guam income tax purposes prior to 1973. See *Sayre & Co.* v. *Riddell,* 395 F.2d 407, 412 (9th Cir. 1968); *Chicago Bridge and Iron Co.* v. *Wheatley,* 430 F.2d 973, 976 (3rd Cir. 1970), cert. denied, 401 U.S. 910 (1971).

(b) Even if Section 932 could not have been "mirrored" prior to 1973 to classify non-Guamanian United States citizens who did not reside in Guam as nonresident aliens of Guam for Guam income tax purposes, the position of the petitioner is still correct. See petition for certiorari, pp. 6-10. That is, since neither the Mannings nor the other non-Guamanian United States citizen shareholders of General Insurers were born or naturalized in Guam, they are clearly aliens of Guam for purposes of the Guam income tax. Section 1.1-1(c) of the Treasury Regulations on Income Tax (1954 Code), as modified pursuant to Section 31(e) of the Organic Act. In addition, since these individuals are not residents of Guam, it must follow that they are treated as nonresident aliens. See Section 1.871-2(a) of the Treasury Regulations on Income Tax (1954 Code), as modified pursuant to Section 31(e) of the Organic Act. Thus, while we

agree with respondents' assertion that Section 932(a) was necessary to treat Guamanian United States citizens who do not reside in the United States as nonresident aliens of the United States for purposes of the United States income tax, the respondents are in error when they assert that Section 932(a) had to be applicable to Guam to treat non-Guamanian United States citizens who did not reside in Guam as nonresident aliens of Guam for purposes of the Guam income tax prior to 1973. *Cf. Sayre & Co.* v. *Riddell, supra.*

4. The Legislative History of the Act of October 31, 1972 Is in Accord With Petitioner's Position in These Consolidated Cases.

In 1972, Congress completely changed the taxation of Guamanian United States citizens, non-Guamanian United States citizens residing in Guam, and non-Guamanian United States citizens with Guam source income, effective for taxable years beginning after December 31, 1972. Act of October 31, 1972, *supra.* Section 935 of the Code provides, in relevant part, that citizens of Guam and non-Guamanian United States citizens are to be taxed in Guam or the United States depending upon their residency at the end of the taxable year. Thus, the adoption of Section 935 of the Code eliminated the dual filing requirement that had been in effect under the Revised Organic Act of Guam prior to 1973. Along with the adoption of the new special tax system for Guam, Section 932 was amended to specifically exclude Guamanians from being classified as nonresident aliens for United States tax purposes. Thus, Guamanians are now (in contradistinction to years prior to 1973) treated in the same manner for tax purposes as are all other United States

citizens. H. Rep. No. 92-1479, *supra*. Accordingly, Guamanians or non-Guamanian United States citizens are now subject to taxation on their worldwide income either by the Government of Guam or the United States depending solely upon their residency at the end of the taxable year. (If the taxpayer is not a resident of Guam or the United States, his return is filed with the jurisdiction from which he derived his United States citizenship. Section 935(b)(1)(C) of the Code).

In considering the legislation that became the Act of October 31, 1972, the House Ways and Means Committee specifically considered the issue in these consolidated cases and stated (H. Rep. No. 92-1479, *supra*):

> * * * [A]ny U.S. citizen or resident may be a shareholder in a so-called subchapter S corporation which is created or organized under the law of Guam *(under present law U.S. Stateside citizens may not be such shareholders since they previously have been classified as non-resident aliens under Guamanian tax law)*. [Emphasis added.]

The Committee statement succinctly states the law as it had consistently been applied to non-Guamanian United States citizens from the inception of the Organic Act of Guam until the decision below.[1] Contrary to the statement by the respondents on page 5 of their brief, the Committee statement emphasizes that non-

[1] As previously noted in the petition for certiorari, pp. 20, 21, *Flores* v. *Government of Guam*, *supra*, is distinguishable on its facts, since it involved a native born Guamanian who was a naturalized United States citizen. These cases do not involve such a Guamanian, but rather involve United States citizens who did not receive their citizenship through any contact with Guam.

Guamanian United States citizens who did not reside in Guam were treated as nonresident aliens of Guam for Guam income tax purposes prior to 1973.

The respondents in these consolidated cases concede that non-Guamanian United States citizens who did not reside in Guam returned and reported to Guam income, and only that income, from Guam sources prior to 1973. This method of reporting income is only available to nonresident aliens under the Internal Revenue Code. Section 871 of the Code. See also Section 1.871-1 of the Treasury Regulations on Income Tax (1954 Code).

For the reasons stated in this reply memorandum, as well as the reasons stated in the petition for a writ of certiorari, we respectfully request this Court to grant the petition. Alternatively, these consolidated cases should be remanded to the Ninth Circuit for a hearing en banc.

Respectfully submitted,

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